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In the Supreme Court of the United States

October Term, 1980

ELIJAH W. RATCLIFF,
Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

I.

That a taxpayer may effectively utilize an accounting system designating interests based upon an attorney-client relationship and an agency coupled with an interest as capital assets even though such designations are not initially evidenced by a notorial act or public record.

II.

That a 50% interest in 100 acres of the DeLoach Estate in the John Burgess Survey of Onalaska, Polk County, Texas may be deemed vested in Petitioner before the taxable year 1971.

III.

That the valuation of the 100 acres of the DeLoach Estate in the John Burgess Survey of Onalaska, Polk County, Texas, a 50% interest of which may be deemed to have vested in Petitioner prior to the taxable year 1971, appreciated in value to exceed $1,000.00 per acre during the calendar and taxable year 1971, and not less than such value immediately preceding such year.

IV.

That Petitioner transferred three-fourths of his claimed 50% interest in the 100 acres of the DeLoach Estate in the John Burgess Survey of Onalaska, Polk County, Texas to the shareholders of Lake Livingston Washateria, Inc., retaining only a one-fourth interest in such premises.

V.

That Petitioner's interest in the subject 100 acres of the DeLoach Estate in the John Burgess Survey of Onalaska, Polk County, Texas was effectively divested through formal condemnation proceedings by the State of Texas coupled with an order by the District Court of Polk County, Texas denying Petitioner and his clients access to relief through the procedures of the State courts in 1971.

VI.

That a 1971 U. S. Small Business Corporation Income Tax Return should be deemed received, accepted and filed by the Internal Revenue Service for the taxable year allocating a Subchapter S loss deduction to Petitioner in the amount of $14,583.33.

VII.

That the subject Subchapter S deduction would have been claimed by Petitioner as a deductible loss incurred in a joint venture engaged for the production of income if the conditions establishing a corporate deduction had not been effected.

VIII.

That the pleadings consisting of the first amended petition for redetermination filed by Petitioner on November 29, 1978 being uncontroverted establish that under the accounting system utilized by Petitioner, the deficiency and negligence penalty assessed by Respondent are invalidated since the deductions as claimed on the 1971 U. S. Individual Income Tax Return offset the gross receipts of Petitioner, such gross receipts as well as deducted losses

having derived from speculative assets, or, alternatively, the gross receipts of Petitioner are substantially less than listed in the notice of deficiency and when offset by the pertinent deductions of Petitioner, under a cash receipts accounting standard, he is placed in a tax bracket creating no income tax liability for the taxable year.

IX.

That the negligence penalty assessed against Petitioner relevant to the filing of his 1971 U. S. Individual Income Tax Return was improper and should be voided in light of the evidence adduced before the Tax Court consistent with the Internal Revenue laws and the requirements of due process under the Fifth and Fourteenth Amendments to the United States Constitution.

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No.

IN THE SUPREME COURT OF THE UNITED STATES

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ELIJAH W. RATCLIFF,

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable Warren E. Burger, Chief Justice, and the Associate Justices of the Supreme Court of the United States:

OPINIONS BELOW

The instant petition seeks reversal of an opinion of the United States Court of Appeals for the Second Circuit wherein Petitioner was Appellant and Respondent was Appellee docketed as No. 80-4090 and not officially reported which was entered on October 16, 1980, and a motion for rehearing en banc denied on December 18, 1980, affirming a decision of the United States Tax Court docketed as No. 2791-75 and officially reported as *Ratcliff v. Commissioner,* 39 T.C. 886 (1980), copies of which are attached hereto as Appendix A.

JURISDICTION

Petitioner seeks reversal of a decision of the United States Court of Appeals, Second Circuit, of October 16, 1980, and the denial of a motion for rehearing en banc December 18, 1980, affirming the United States Tax Court, pursuant to Title 28, *United States Code,* Sections 1254-(1) and 2106. The United States Tax Court sustained Respondent's determination of a deficiency and negligence penalty against Petitioner even though the deduction and exclusions claimed by Petitioner were sound and authorized by cited provisions of the Internal Revenue Code, and its related refusal to grant Petitioner's Motion for Reconsideration was contrary to prevailing precedents, including *Stoody v. Commissioner,* 67 T.C. 643 (1947). Such errors all substantively derived from Respondent's misleading representations which circumvented plenary development of the facts in the Tax Court, and present a question of the denial of due process and equal protection of the laws under the Fifth and Fourteenth Amendments to the United States Constitution.

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

This petition questions the validity of no constitutional or statutory provision per se, but merely contests the application of Title 26, *United States Code,* Section 165 (a), *as related to* Sections 212, 446, 1231 (a), 1371-1379, *inclusive,* 6012 *and* 6653 (a), and *Reg.* §1.446-1 (e)-(1) as effected by Respondent and its representatives when compared to standards dictated by *United States Code, Const. Amend. V and XIV,* and the related Title 42, *United States Code,* Sections 1981, 1982 and 1983, as well as other supporting legislation, assuring due process and equal protection of the laws.

STATEMENT OF THE CASE

During the taxable year 1969 a certain contractual relationship was created between Petitioner and a party of relatives and former neighbors at Onalaska, Polk County, Texas as evidenced by records which were not produced for the United States Tax Court from the Trinity River Authority of Texas by Petitioner because Respondent's responses to pre-trial discovery as well as trial court interrogation suggested the omitted evidence was not in dispute (see USCA Appx. pp. 13-16, 19-21, 22, 23, 24-25, 26-28, 29 and 30; USTC Tr. p. 2, lines 12-15 and 23-25, pp. 3-5, line 1). The subject contractual relationship was treated by Petitioner as an asset vesting in the taxable year 1969, and Respondent did not contest Petitioner's valuation of such asset in the United States Tax Court (see USTC Tr. p. 2, lines 12-15 and 23-25, pp. 3-5, line 1), consisting of 100 acres, more or less, of farm and recreation realty in the John Burgess Survey of Onalaska, Polk County, Texas and arising out of a partial donative and partial compensatory intent.

The subject asset was unequivocally divested of Petitioner and his clients during the taxable year 1971 (see USTC J. Ex. No. 7-G, Evid. p. 33), and the event was treated as a loss on Petitioner's 1971 U.S. Individual Income Tax Return (USTC J. Ex. No. 1-A, Evid. p. 25; USCA Appx. pp. 35-54).

Respondent's notice of deficiency disallowed the described loss serving to increase Petitioner's taxable income in the amount of $12,500.00.

The notice secondly disallowed a loss incurred through a business entity referred to as Lake Livingston Washateria, Inc., or Lake Livingston Washateria, Elijah W. Ratcliff, Proprietor, located on a part of the George Qualls Survey in Onalaska, Polk County, Texas in the amount of $14,583.33 in spite of returns and schedules having been legally received and filed by the Internal Revenue Service pursuant to Subchapter S of the Internal Revenue Code. Title 26, *United States Code,* Section 1371-1379, inclusive.

Also, the Notice of Deficiency included a negligence penalty purporting to be required by Title 26, *United States Code, Section* 6653(a), the propriety of which is refuted by the evidence substantiating the contested deduction, simultaneously, relevant to the return (USTC Appx. pp. 59-66, Answers to Respondent's Interrogatories to Petitioner; also, SF p. 2, Document No. 67).

Petitioner's amended petition (USTC Document No. 69, USCA Appx. pp. 31-34) showed through pleadings the absence of income tax liability on his part, and such petition was never controverted in the Tax Court (USTC SF p. 2, Document No. 67). Respondent offered no evidence whatsoever to controvert Petitioner's alternative claim that if his quasi-accrual system of accounting was deemed improper, then the speculative assets assigned to 1971 income were not properly includible as income, thus, reducing his gross receipts and resulting taxable income to a bracket alleviating liability in any amount for the taxable year. Title 26, *United States Code,* Section 7442.

ARGUMENT

Discussion of Facts and Authorities Resolving Question I:

The issue which developed following pre-trial procedures to be paramount among the matters to be determined herein concerns the accounting system utilized by Petitioner in designating certain tangible and presumptively enforceable advantageous relationships as capital assets at the time the relationship became binding. The Internal Revenue Code does not explicitly and specifically authorize any single accounting method to the exclusion of others. Title 26, *United States Code,* Section 446 (c) allows four broad categories of accounting methods for a taxpayer, and the second, third and fourth methods provided by the subsections are totally consistent with the method presumptively adopted by Petitioner (see Petitioner's 1971 U. S. Individual Income Tax Return, USTC J. Ex. 1-A, Evid. p. 25, Document No. 67; USCA Appx. pp. 35-54). Reg. §§1.446-1 (a) (2) and 1.446-1 (e) (1).

Petitioner is entitled to deduct the condemnation loss incurred during the taxable year 1971 in the amount of $12,500.00 for his individual interest in the John Burgess Survey of Polk County, Texas which was condemned under eminent domain authority without compensation; alternatively, the "Realty Acquired in 1971" and the "Judgments Secured in Texas During 1971 with Realty Subject to Lien" included in Petitioner's gross receipts for the tax-

able year 1971 should be discounted, thus reducing his gross receipts to $9,801.30 (USCA Appx. pp. 39, 45 and 46).

Petitioner's 1971 income tax return was computed under the method of accounting on the basis of which he regularly computes his income in keeping his records. Reg. §§1.446-1 (c) (1); 1.451-2.

The evidence clearly shows that the applicable property vested under the quasi-accrual accounting method engaged prior to December 31, 1968 (USTC SF p. 47, Document No. 67; USCA Appx. p. 57), and the interests of Petitioner and his clients were not legally determined to be unrecoverable by them until on or about December 24, 1971 (USTC J. Ex. 7-G, Evid. p. 33, Document No. 67, USCA Appx. p. 55). Title 26, *United States Code,* Section 446 (c) (2), (3) and (4).

The legal disposition of the condemnation proceedings should have been reflected by the records of the County Court of Polk County, Texas. However, Petitioner has given testimony repetitiously that neither the intent to finalize nor the entry of a condemnation judgment, or judgments, revealed itself, in spite of Petitioner's constant surveillance until the calender year 1971 (USTC SF pp. 40, lines 16-22; 42-43; and 47-48; Document No. 67, USCA Appx. 57-58). Petitioner gave testimony of these facts and Respondent was urged to observe such records prior to the trial so it could be observed that notice and communications were sub-par with respect to the pending proceeding even though it was clear and official that Petitioner was the Attorney of Record for a slate of interested parties in the proceedings (see Answers to Respondent's Interrogatories to Petitioner attached to Reply Brief of

Petitioner, USCA Appx. pp. 59-66, and specifically paragraphs II, III, IV, VIII, XI, XII, XIII, XVII, XVIII, XX and XXI thereof).

Accounting for income should not be equated with filing a return showing such income for such filing with the Internal Revenue Service is not required in designated brackets. Title 26, *United States Code,* Section 6012(a)-(1) (A) (i).

Also, it is noteworthy that the statute of frauds does not preclude the subject accrual, the same being an effective unwritten contract between an attorney and his clients. *Vernon's Ann. Rules Civ. Proc.,* Rule 94.

Cases decided under *Vernon's Ann. Civ. St.,* Art. 3395(4), which preceded *V.T.C.A.,* Bus. & C. §26.01, consistently held that because the English statute of frauds included the language "or an interest in, or concerning real estate," which is omitted from the Texas statute, many verbal agreements concerning real estate are valid which would have come within the terms of the English statute. These earlier Texas precedents have been authoritatively associated with the current legislation, and, thus, the statute is not applicable to a contract for the joint acquisition of an interest in realty by a plaintiff and another where part of the money and services in the venture are furnished, as in our facts, by the party asserting the relationship. *De Proy v. Progakis,* 259 S.W. 620 (1924); *Wood v. Gulf Production Co.,* 100 S.W. 2d 412 (1936).

Petitioner maintains that the interests of Etta DeLoach Sykes, et al., were not discharged in 1970 or earlier because the officers of the County Court of Polk County,

Texas had a duty to notify Petitioner of any proposed dispositive proceeding in the matters, which notification was not received prior to 1971 even though he was the Attorney of Record in the pertinent series of condemnation hearings representing multiple heirs of the DeLoach Estate. *Murray v. Kunzig,* 462 F.2d 871 (D.C. Cir. 1972), reversed on other grounds, 415 U.S. 61 (1974), 39 L.Ed. 2d 166, 94 S.Ct. 937; *Rules Prac. Proc., U.S. Tax Court,* Rule 143 (a), 26 U.S.C., Sec. 7453; *Fed. Rules Civ. Proc.,* Rule 43 (a), 28 U.S.C., Sec. 2072.

The suit finally filed by Petitioner in behalf of his clients was a product of the failure of County Court officials of Polk County, Texas, or other County magisterial personnel, to communicate with him and his clients regarding developments or lack of developments in the condemnation litigation (USTC J. Ex. 3-C, Evid. p. 3, Document No. 67).

If Respondent had sought the advice of realty experts in the relevant area as an adversary standard of due diligence would require, he would have secured evidence supporting the valuations set by Petitioner who is an attorney, who had nine years of experience in realty matters in the pertinent East Texas, and general Texas, area at the time the subject valuations were made (see USTC J. Ex. 1-A, Evid. p. 33, Document No. 67, USCA Appx. pp. 45-46; USTC SF pp. 22, 41 and 50, Document No. 67; also, Answers to Respondent's Interrogatories to Petitioner attached to Reply Brief of Petitioners, USCA Appx. pp. 59-66).

Argument

Discussion of Facts and Authorities Resolving Question II:

The subject notice of deficiency disallows a deduction for a remaining interest in 100 acres of land in the John Burgess Survey of Polk County, Texas. Such interest in Petitioner having an appreciated value of $12,500.00 with respect to Petitioner's remaining interest after a partial transfer to Lake Livingston Washateria, Inc., derives from a combination of donative and compensatory intents of certain relatives he represented in condemnation proceedings initiated by the Trinity River Authority of Texas which were recapitulated to the Internal Revenue Service as having been equitably inventoried during the taxable years 1969 and 1970. Title 26, *United States Code,* Section 1013. Such interest vested and was held as a capital asset by Petitioner based upon an agency relationship coupled with an interest derived with respect to the property from a contractual relationship flowing from his clients, who in the context were relatives, also.

The recovery which Petitioner determined to be proper for his enhancement was 50% of the total realty in issue, which is consistent with the recommendations of the Minimum Fee Schedule of the State Bar of Texas in eminent domain proceedings at page 24 of the schedule.

Discussion of Facts and Authorities Resolving Question III:

Petitioner inventoried the subject realty in the John Burgess Survey of Polk County, Texas at the appreciated value of $1,000.00 per acre, based not only on his direct

observations of the increased value of real estate in the locality between 1967 and 1971, but several property owners including Harley Hayes of Onalaska, Polk County, Texas, and real estate appraisers, including Brodie Jones of Moscow, Polk County, Texas were consulted formally preliminary to setting the valuation as recited in the 1971 income tax returns pertinent to the instant litigation (USTC SF pp. 30, lines 5-9, and 32, lines 17-25, Document No. 67).

Petitioner filed Rule 71(d) Interrogatories (USTC Document No. 62; USCA Appx. pp. 26-28; also, see USTC Document No. 63 and 66; USCA Appx. pp. 29 and 30) seeking to compel Respondent to disclose its experts on the issue of valuation, and its response before the Tax Court was that the valuations were not contested so this issue was presumed to be moot until briefs were filed (USTC Document No. 69; USCA Appx. pp. 31-34, and USTC Document No. 73). *Ryan v. Commissioner,* 67 T.C. 212 (1976); *Keneipp v. United States,* 184 F.2d 263 (D.C. Cir. 1950); *Helis v. Usry,* 496 F.2d 1321 (5th Cir. 1974).

A tax return was filed by Lake Livingston Washateria, Inc., for the taxable year 1971 which allocated a loss to Petitioner in the amount of $14,583.33 representing the rate of equity he held as a shareholder in the Corporation for the taxable year (USTC J. Ex. 1-A, Evid. p. 25; USCA Appx. pp. 35-54, and USTC P. Ex. 16, Evid. p. 79; 17, Evid. p. 83; 18, Evid. p. 83; and 19, Evid. p. 84, Document No. 67). The detailed records of the Corporation's day to day activities were made available to Respondent for inspection or copying, and Petitioner presumed that such records and the related issues were

no longer unresolved (see Answers to Respondent's Interrogatories to Petitioner attached to Reply Brief of Petitioner, USCA Appx. pp. 59-66; also, USTC SF pp. 65-68, Document No. 67).

Another unfortunate feature of the docket which is suggested by virtue of the briefs filed herein, but not at earlier stages, is that the trial attorney for Respondent was not in proximity with all stages of the litigation and had not reviewed the files to observe the matters preliminary to his entry. The matter of the detailed records of Lake Livingston Washateria, Inc., was addressed during pretrial discovery efforts in March of 1977, at which point the importance of such data was elaborated upon and specified, apparently satisfactorily to Respondent's Counsel of Record at the described stage (see USTC Docket Record for discovery efforts between February 10, 1977 and December 31, 1977 and specifically USCA Appx. pp. 59-66). The United States Tax Court was obligated to take judicial notice of the indicated evidence. *Rules Prac. Proc., U.S. Tax Court,* Rule 143 (a), 26 U.S.C., Sec. 7453; Fed. Rules Evid., Rule 201 (d), 28 U.S.C.

Discussion of Facts and Authorities Resolving Question IV:

Petitioner formally conveyed a percentage of his interest in the Estate of DeLoach realty which had vested in an earlier taxable year to the Shareholders of Lake Livingston Washateria, Inc., most of whom were related by sanguinity to the members of the Estate of DeLoach in a degree similar to Petitioner's and such appeared to be consistent with one controlling objective on the part

of certain grantors (USTC J. Ex. 20, Evid. p. 86 labeled Petitioner's Exhibit 20). This point should be cleared by the import of the recorded deed coupled with the tax return filed by Lake Livingston Washateria, Inc., pertinent hereto, which return was ultimately expressly accepted by the Internal Revenue Service as filed (USTC J. Ex. 16, Evid. p. 79, labeled Petitioner's Exhibit 16).

Thus, Petitioner is entitled to a deduction for an allocated Subchapter S loss from Lake Livingston Washateria, Inc., in the amount of $14,583.33 for the taxable year 1971.

Title 26, *United States Code,* Section 1373(a), provides that the undistributed taxable income of an electing small business corporation for any taxable year shall be included in the gross income of the shareholders of such corporation; and Title 26, *United States Code,* Section 1374(a), provides that a net operating loss for any taxable year shall be allowed as a deduction from gross income of the shareholders of the corporation.

Only certain lines carried a quantitative entry on the Corporation's returns because only limited activities were engaged in during the pertinent taxable years attributable to the beginning nature of the business as well as a less than enthusiastic welcome for a black enterprise in the given locality. However, the returns accurately reflect the summarized business activities as indicated, and the specifics were presumed to have been satisfactorily exhausted during pre-trial proceedings.

Also, a notation on the questioned return that the election by Lake Livingston Washateria, Inc., as a small business corporation was made on March 6, 1971 is not

inherently misleading for the promoters and directors of the Corporation elected to be treated as a small business corporation long before the certificate of incorporation was issued by the State of Texas, but the election was rendered effective under State law and the Corporation's articles of incorporation and by-laws upon the issuance of such certificate of incorporation. *Vernon's T.B.C.A.*, Art. 2.02.

Discussion of Facts and Authorities Resolving Question V:

A miscarriage of justice by the District Court of Polk County, Texas, Ninth Judicial District, No. 7957, divested Petitioner, his clients and his assignees of all interests obtained in the Estate of DeLoach in the John Burgess Survey of Onalaska, Polk County, Texas. The title preliminary to Petitioner's claim had been perfected through ancestors of Tony and Ben DeLoach, residents of Onalaska, Polk County, Texas, no less than 50 years prior to the litigation in question. Tony and Ben DeLoach purported to accomplish a partition of the subject premises between them with each party's partition exceeding 100 acres of land. Petitioner's clients were in the chain of Ben DeLoach's title, and the partition agreement itself preceded the Trinity River Authority of Texas activities by not less than 50 years.

Notwithstanding the described well-established and recognized chain of title flowing to Petitioner's clients, the District Court of Polk County, Texas with Judge J. S. Holleman presiding in Docket No. 7957 entered an order precluding recovery by Petitioner's clients, and the condemnation proceedings previously concluded, thus, effec-

tively divested the premises without compensation contrary to the requirements of the *Fifth* and *Fourteenth Amendments* to the Federal Constitution and Article I, Section 19, of the *Texas Constitution* (USTC J. Ex. 7-G, Evid. p. 33, Document No. 67; USCA Appx. p. 55). *Vernon's Ann. Tex. Const.*, Art. I, Sec. 19; *United States Code, Const. Amend. V and XIV.*

The described divestiture was claimed by Petitioner and his assignees as a deduction for the taxable year 1971, as the order denying relief of the courts was entered in such year. Title 26, *United States Code,* Sections 165 (a) and (c) (1) and (2) and 1231 (a).

Discussion of Facts and Authorities Supporting Question VI:

The deficiency notice herein inappropriately denies a Subchapter S deduction properly claimed by Petitioner in the amount attributed to him by the subject Corporate return. No contest or audit was ever initiated on the 1971 U. S. Small Business Corporation Income Tax Return as filed by Lake Livingston Washateria, Inc., with the Internal Revenue Service allocating a net operating loss to Petitioner to the extent of $14,583.33. Petitioner as an officer of the subject Corporation has reason to believe that any questions regarding such return could have been satisfactorily resolved upon timely notification to the Corporation by the District Office receiving the return of any proper realm of inquiry. *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296 (1946), 91 L.Ed. 2d 296, 67 S.Ct. 271; *Continental Equities, Inc. v. Commissioner,* 551 F.2d 74 (5th Cir. 1977).

Argument

The total investment by Petitioner in the Corporation, including the costs of the shares issued to him, comprising the adjusted basis for his shares, clearly exceeded the amount of the loss allocated to him by the 1971 Income Tax Return of Lake Livingston Washateria, Inc. (USTC J. Ex. 17, Evid. p. 83, Document No. 67, labeled Petitioner's Exhibit 17), and poses no legitimate basis issue.

Discussion of Facts and Authorities Resolving Question VII:

The basis for Petitioner's shares in Lake Livingston Washateria, Inc., was derived from the total of (1) his cash investment of $4,000.00; (2) an automobile owned by Appellant damaged to the extent of a total loss in the service of the Corporation valued at $3,000.00; (3) realty in the George Qualls Survey of Polk County, Texas, in the amount of Petitioner's personal interest contributed to the Corporation's capital, $7,000.00 (USTC J. Ex. 1-A, Evid. p. 25, Document No. 67; USCA Appx. p. 46); and (4) one-third of the three-fourths interest from the Estate of DeLoach which Petitioner transferred to the Corporation for the benefit of shareholders valued at $12,500.00 for a total adjusted basis of $26,500.00 which basis exceeded the Subchapter S loss allocated to Appellant from the Corporation for the taxable year to the extent of $11,916.67 (USTC P. Ex. 16, Evid. p. 79; 20, Evid. p. 85; and 21, Evid. p. 88; SF pp. 84-85, 86-99, and 102-103; Document No. 67). Reg. §1.1374-1 (b) (4) (a) and (b).

Argument

Discussion of Facts and Authorities Resolving Question VIII:

While the plan for a business enterprise by Petitioner along with his associates and fiduciaries in Lake Livingston Washateria, Inc., had been initiated for several years in light of the development of the Livingston Dam and Reservoir Project, its ultimate organization was intended to comply with the provisions of Subchapter S of the Internal Revenue Code so as to create a potential tax shelter if profits were not immediately overriding as compared with expenses. Title 26, *United States Code,* Section 1371 to 1379, inclusive; *Becher v. Contoure Laboratories,* 279 U.S. 388 (1929), 73 L.Ed. 752, 49 S.Ct. 356.

If the entity created was not a *de jure* corporation attributable to defects in its structure, the effect derived by the shareholders, including Petitioner, of the Corporation could have been attained by substituting the Subchapter S loss with a loss incurred through a joint venture engaged for the production of income. Title 26, *United States Code,* Section 212. However, this issue has never validly arisen for the contents of the 1971 U. S. Small Business Corporation Income Tax Return in focus have never been examined, audited or otherwise controverted. Furthermore, the Internal Revenue Service acknowledged by correspondence admitted as evidence herein that the Corporation's return for the subject year was filed as presented (See USTC J. Ex. 16, Evid. p. 79, labeled Petitioner's Exhibit 16, Document No. 67). *Standard Paving Company v. Commissioner,* 190 F.2d 330 (10th Cir. 1951), *cert. den.* 342 U.S. 860 (1951), 96 L.Ed. 2d 647, 72 S.Ct. 87.

Argument

Under the diction of Texas law, Petitioner as a licensed Texas lawyer for more than nine years at the pertinent time concluded that not only was the asset arising from the Estate of DeLoach in the John Burgess Survey of Polk County, Texas, proper for treatment as an economic gain in 1969, but that, similarly, the realty conveyed as a trust to him in the George Qualls Survey of Onalaska, Polk County, Texas, and the Anderson County, Texas realty in the John Bryan Survey in which an equitable lien was created in favor of Petitioner, all in 1971, should be treated as economic gains (USCA Appx. pp. 39, 45 and 46). However, the assets in each instance were speculative and subject to the diversified obstacles with which Negroes have been historically confronted in East Texas, and, as the situation developed, the assets included in 1971 income as speculative assets turned out to be as valueless as the asset attributed to 1969 income. (See *Ratcliff v. Sherman,* 592 S.W. 2d 81 (1980), where the trial Court Reporter and District Clerk refused to timely prepare the record through no fault of Petitioner, and the State Appellate Court refused to apply Rules 21(c), 428 or 429 of the Texas Rules of Civil Procedure to permit a review of the trial court record. See, also, *Lake Livingston Washateria, Inc. v. Hasty,* 566 F.2d 104 (1977), *cert. den.* 435 U.S. 1007 (1978), 56 L.Ed. 2d 389, 98 S.Ct. 1878, where federal courts refused to intervene to prevent or otherwise remedy the wrongful taking of Washateria premises obviously in violation of the civil rights of Petitioner along with his associates and fiduciaries).

Argument

Discussion of Facts and Authorities Resolving Question IX:

It follows that with a determination that the deductions claimed by Petitioner on his 1971 U. S. Individual Income Tax Return were proper, or that the alternative claim set forth in the first amended petition for redetermination should prevail, the negligence penalty assessed by the Internal Revenue Service is improper. Title 26, *United States Code,* Section 6653 (a), contemplates clear impropriety in the preparation of one's tax return as a prerequisite to the assessment of a negligence penalty, and under the facts adduced in the Tax Court proceeding, such penalty is unequivocally contraindicated. *Keneipp v. United States,* 184 F.2d 263 (D.C. Cir. 1950).

Each of the inclusions, exclusions and deductions on the subject return were sound, rational, prudent and prescribed by the Internal Revenue Code as well as the Regulations promulgated thereunder.

To cover all the records Respondent now suggests were proper for Tax Court evidence would have duplicated the progress and accords which Petitioner concluded were accomplished through pre-trial procedures during the calendar year 1977 (see USTC Document No. 22, 26, 27, 38, 45, 57, 62, 66 and 68; also, attachment to Document No. 79; USCA Appx. pp. 59-66). *Rules Prac. Proc., U.S. Tax Court,* Rules 70-104, 26 U.S.C., Sec. 7453, inclusive.

As the gigantic gains contemplated following enhancement of real estate values in the John Burgess Survey of Polk County, Texas, following the calendar year 1968 in fact resulted in total losses, Petitioner's Rule 71 (d) Interrogatories to Respondent (USTC Document No. 62; USCA Appx. pp. 24-28) served on September 6, 1978 inquiring

about the expert witnesses on valuations Respondent would utilize were intended to intercept and preclude any skepticism arising out of conceivable variations in values associated with the realty and personalty relevant to the subject return. *Rules Prac. Proc., U. S. Tax Court,* Rule 71 (d), 26 U.S.C., Sec. 7453.

Taxpayers in certain precedential cases such as *Bunnel v. Commissioner,* 50 T.C. 837 (1968); *Jewett v. Commissioner,* T.C.M. 1966-295; and *Marcello v. Commisioner,* 43 T.C. 168 (1964), under facts contrary to the instant proceeding, failed to produce records even though no restraints prevented their production. The reasons were presumably that the true records would not have supported the asserted claims. However, our facts are that as soon as Petitioner was relieved of certain precluding and fraudulent restraints, he located the subject records and offered them to Counsel for Respondent to accomplish inspection and copying during no less than twelve months, successively, in the calendar years 1977 and 1978, and reasonably in advance of the trial held in the cause during November of 1978 (USTC Document No. 27, 38, 44 and 45). *Rules Prac. Proc., U.S. Tax Court,* Rules 70, 71, 72, 90, 103 and 104, 26 U.S.C., Sec. 7453. Such records, furthermore, remain available. *O'Neill v. United States,* 79 F. Supp. 827 (E.D. Pa. 1948); *Allen v. United States,* 16 Fed. Rules Sev. 37b.21, Case 1 (1951); *Maresco v. Lambert,* 2 F.R.D. 163 (1941).

Where the Commissioner's evidence is shown to be arbitrary and insufficient resulting in an excessive determination, the burden of going forward with the evidence may reasonably be placed on him. *Helvering v. Taylor,* 293 U.S. 507 (1935), 79 L.Ed. 623, 55 S.Ct. 287; *United*

States v. Janis, 428 U.S. 433 (1976), 49 L.Ed. 2d 1046, 96 S.Ct. 3021.

Reg. §§1.446-1 (a) (4) (ii) and (iii); 1.446-1 (e) (1) (iv); and 1.451-2 specifically allow for the quasi-accrual method of accounting which Petitioner adopted and consistently uses, and it follows that no negligence can be conjured solely based upon his regular use of such system. *Magnolia Petroleum Co. v. Thomas,* 151 F.2d 1008 (5th Cir. 1945), *cert. den.* 327 U.S. 799 (1946), 90 L.Ed. 1025, 66 S.Ct. 901; *Coughlin v. Commissioner,* 203 F.2d 307 (2nd Cir. 1953); *Technitrol, Inc. v. United States,* 440 F.2d 1362 (CC 1971); Title 42, *United States Code,* Sections 1981 and 1982; *United States Code, Const. Amend. V and XIV.*

Conclusion

The deficiency and negligence penalty assessed on the tax liability of Petitioner for the taxable year 1971 should be voided, giving due consideration to the pleadings as well as the evidence presented herein, and a final ruling should be entered, invalidating the deficiency and penalty assessed against Petitioner and remanding the cause for further factual development by the United States Tax Court and giving due significance to the first amended petition for redetermination filed herein (USTC Document No. 69; USCA Appx. pp. 31-34). *Rules Prac. Proc., U.S. Tax Court,* Rule 31 (c), 26 U.S.C., Sec. 7453.

ELIJAH W. RATCLIFF
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Livingston, Texas 77351
Ph. 713 327-4948
Petitioner, Pro Se

AFFIDAVIT OF SERVICE

State of Texas
County of Harris

Petitioner, Pro Se, states under penalties of perjury as if executed before a proper Notary Public that a copy of the foregoing Petition for Writ of Certiorari was served this day of , A.D., 1981, by first class United States Mail on Counsel of Record for Appellee addressed to: Hon. M. Carr Ferguson, Assistant Attorney General, Tax Division, U. S. Department of Justice, Washington, D. C. 20530, in triplicate.

Affiant

APPENDIX, PART A

T.C. Memo. 1980-12

UNITED STATES TAX COURT

ELIJAH W. RATCLIFF, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 2791-75. Filed January 17, 1980

Elijah W. Ratcliff, pro se.

Robert B. Perry, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SCOTT, *Judge:* Respondent determined a deficiency in petitioner's income tax for calendar year 1971 in the amount of $6,435.36 and an addition to tax under section 6653(a), I.R.C. 1954,[1] in the amount of $321.77. The issues for decision are (1) whether petitioner is entitled under section 165 to a condemnation loss in the calendar year 1971, and, if so, the amount thereof; (2) whether petitioner properly claimed a loss of $14,583.33 from the operation of Lake Livingston Washateria, Inc., for the calendar year 1971; and (3) whether any part of

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect in the years in issue.

an underpayment of tax for the calendar year 1971 is due to petitioner's negligence or intentional disregard of the rules and regulations under section 6653 (a).[2]

FINDINGS OF FACT

Petitioner Elijah W. Ratcliff, lived at Tennessee Colony, Texas, at the time of filing his petition in this case. Petitioner filed his individual Federal income tax return for the calendar year 1971 with the Internal Revenue Service Center, Holtsville, New York.

On December 20, 1968, Trinity River Authority of Texas, a State governmental agency, filed a Petition for Condemnation, No. 1115, with the County Court of Polk County, Texas, captioned Trinity River Authority of Texas vs. Andrew DeLoach, et al. The named individual de-

[2] At the trial petitioner filed an amended petition alleging error in the disallowance of itemized deductions for medical expenses, taxes, and contributions and a theft loss totaling $706.66. In lieu of these claimed itemized deductions respondent allowed a standard deduction of $1,500. On brief petitioner states that the disallowance of the itemized deductions is not in issue. The amended petition also alleged that petitioner was entitled to a casualty loss because of an automobile accident which demolished a Vega automobile. At the trial petitioner offered no evidence as to the year of the accident or any other information with respect to the alleged casualty loss. Petitioner does not mention this alleged loss on brief, and we assume petitioner has abandoned this claimed loss. If he has not abandoned any such claimed loss, clearly on this record he has failed to prove that he had any casualty loss in connection with a Vega automobile in the calendar year 1971.

fendants were Andrew DeLoach, Tony DeLoach III, a/k/a T. S. DeLoach as well as Tony DeLoach, Jr., Collins DeLoach, Leo DeLoach, Coleman DeLoach, Mattie DeLoach Evans and Lila DeLoach King. As a result of plaintiff's exercising its power of eminent domain, a Polk County tract of land, E-56 in the John Burgess Survey, owned by defendants was confiscated. On April 11, 1969, judgment was entered in condemnation proceeding No. 1115 which awarded defendants $6,481.25.

Trinity River Authority of Texas filed another Petition for Condemnation, No. 1116, on December 20, 1968, with the County Court of Polk County, Texas, captioned Trinity River Authority vs. Tony DeLoach III, et al. Etta DeLoach Sykes and Novella DeLoach Ashley were amongst those named defendants. As a result of plaintiff's exercising its power of eminent domain, tracts of land, E-53 and E-54 in the John Burgess Survey, owned by defendants were confiscated. On June 2, 1970, judgment was entered in condemnation proceeding No. 1116 which awarded $33,600.35 to defendants. The judgment ordered that Trinity River Authority pay the award to the registry of the County Court for retention until the Second 9th Judicial District Court of Polk County, Texas, had rendered a final decision in pending case No. 7754.

District Court Case No. 7754, captioned "Lila King, et al. vs. Novella DeLoach Ashley, et al.", was an action in trespass to try title of Polk County tracts E-53 and E-54. Plaintiffs claimed title by peaceable and adverse possession for at least ten years. Etta DeLoach Sykes and Amos Hayes were named defendants. Etta DeLoach Sykes was served with a citation of that proceeding on April 19, 1969, the reverse side of which she signed.

Judgment by Consent was entered in the action in trespass to try title on November 24, 1970. Title was quieted by awarding plaintiffs an undivided 0.8046875 interest in tracts E-53 and E-54, subject to the rights of Trinity River Authority of Texas as awarded in County Court condemnation proceeding No. 1116. The Judgment by Consent awarded an undivided 0.0703125 interest in tracts E-53 and E-54 to those defendants who were the heirs of Whit DeLoach. That judgment further awarded an undivided 0.1250 interest in those tracts to the heirs of Ben DeLoach, including amongst others, defendants Etta DeLoach Sykes and Amos Hayes.

Petitioner was not shown as attorney of record for any party in any of the above-listed court proceedings.

On April 12, 1971, as named attorney of record, petitioner filed in the District Court of Polk County, Texas, action No. 7957 on behalf of Etta DeLoach Sykes and Amos Hayes against Trinity River Authority of Texas. Therein, plaintiffs sought $50,000 actual and $250,000 punitive damages against defendant who had "initiated effective condemnation proceedings but refused to conclude, terminate or discontinue such proceedings resulting in damages to Plaintiffs". In December 1971 the court dismissed the case based upon lack of jurisdiction and collateral estoppel.

There was no written agreement between petitioner and Etta DeLoach Sykes as to the compensation petitioner was to receive for his legal efforts. Etta DeLoach Sykes died in 1971.

On May 6, 1971, Lake Livingston Washateria, Inc. (Washateria), became a chartered corporation in Texas. The charter was revoked during 1975. Between those

years petitioner was a shareholder in Washateria. Small Business Corporation income tax returns were completed for tax years 1971, 1972 and 1973. The 1971 tax return showed a loss of $37,500.

Petitioner purchased a Chevrolet Vega in 1971; title was issued in his name. Title to the Vega was never transferred to Washateria. The Vega collided with a truck while petitioner was driving it; that collision demolished the Vega. Petitioner had the Vega towed from the site of the collision by a wrecking service in Livingston, Texas. He replaced the Vega with a 1972 Plymouth.

Petitioner on his Federal income tax return for the calendar year 1971 claimed a condemnation loss of $12,500 for "One hundred (100) acres of Farm and Recreation Realty in John Burgess Survey, Polk County, Texas, through Condemnation Without Compensation," and a small business loss of $14,583.33. Respondent disallowed these claimed deductions in their entirety with the following explanations:

> (a) It is determined that the amount of $12,500.00 claimed as a Condemnation loss on one hundred acres of Farm and Recreation Realty in John Burgess Survey, Polk County, Texas, is not allowable because it has not been established that any deductible loss was sustained during the taxable year. Accordingly, taxable income is increased $12,500.00.
>
> (b) It is determined that the amount of $14,583.33 claimed as a loss resulting from the operation of Lake Livingston Washateria, Inc. is not allowable because it has not been established that any deductible loss was sustained during the taxable year. Accordingly, taxable income is increased $14,583.33.

OPINION

The first issue for decision is whether petitioner is entitled under section 165 to a condemnation loss of $12,500 in the calendar year 1971. In order for a taxpayer to be entitled to a condemnation loss, he must have a prior ownership interest in the land confiscated. Petitioner asserts that he received a vested property interest prior to December 31, 1968, in 100 acres of land located in the John Burgess Survey, Polk County, Texas. He contends that as a result of the donative and compensatory intents of certain relatives, particularly Etta DeLoach Sykes, by oral promise he received a 50 percent interest in those 100 acres of Polk County land.

The compensatory nature of the alleged land transfer presumably resulted from petitioner's having rendered legal services to members of the DeLoach family and specifically to Etta DeLoach Sykes. Petitioner argues that he represented those persons as defendants in either condemnation proceeding No. 1115 or No. 1116. Trinity River Authority of Texas filed both law suits as a means of exercising its power of eminent domain on December 20, 1968, in the County Court of Polk County, Texas. Proceeding No. 1115 affected Polk County tract E-56, while No. 1116 concerned tracts E-53 and E-54 in the John Burgess Survey.

The County Court judgments directed the Trinity River Authority of Texas to pay the DeLoach family members sums of money as a result of the confiscation of the Polk County lands. However, on June 2, 1970, when judgment was entered in condemnation proceeding No. 1116, a

suit contesting the ownership of tracts E-53 and E-54 was pending in the District Court of Polk County. As a result, the County Court judgment for Docket No. 1116 ordered that Trinity River Authority pay the $33,600.35 award to the registry of the County Court for retention until the District Court rendered a final decision.

Title was quieted in the District Court action in trespass to try title, No. 7754, captioned Lila King, et al. v. Novella DeLoach Ashley et al., on November 24, 1970. The heirs of Ben DeLoach, including Etta DeLoach Sykes and Amos Hayes, were awarded by the District Court an undivided 0.1250 interest in tracts E-53 and E-54. Consequently, the County Court award in proceeding No. 1116 became available to the defendants therein, which qualified Etta DeLoach Sykes to receive an interest of approximately $300 in the Polk County property.

It is that property interest to which petitioner insists he was entitled. Petitioner asserts that his legal representation of the DeLoach family members in the Texas County Court and District Court cases gave him a 50 percent claim to the 100 acres. Contrary to petitioner's position that he was the attorney of record in those cases, the record in the instant case does not indicate that he assumed that position.

Texas Rules of Civil Procedure, Rule 10, defines attorney of record as—

> An attorney of record is one who has appeared in the case, as evidenced by his name subscribed to the pleadings or to some agreement of the parties filed in the case; and he shall be considered to have continued as such attorney to the end of the suit in the trial

court, unless there is something appearing to the contrary in the record.

Petitioner's name was not subscribed to the pleadings or some agreement filed by the parties in proceedings No. 1115, No. 1116, and No. 7754. The only suit in which petitioner acted as the named attorney of record was an action on behalf of Etta DeLoach Sykes and Amos Hayes against Trinity River Authority of Texas filed as docket No. 7957 in the District Court of Polk County on April 12, 1971. That case sought actual and punitive damages against defendant for refusing to conclude, terminate, or discontinue the County Court condemnation proceedings. Proceeding No. 7957 was dismissed by the District Court for lack of jurisdiction.

It appears from this record that any rights in property which petitioner might have received by virtue of his rendering legal services as attorney of record to Etta DeLoach Sykes specifically with respect to the April 12, 1971, case necessarily would have arisen after December 31, 1968. Because petitioner claims that his property interest firmly vested before December 31, 1968, any such interest could not have resulted from his legal services with respect to District Court proceeding No. 7957.

While petitioner claims that he legally represented Etta DeLoach Sykes and other DeLoach family members in the condemnation proceedings and the action in trespass to try title, there is no confirmatory evidence in the record that he represented in any legal capacity their interests in those suits. The suit to quiet title No. 7754 lists another attorney as the attorney for the DeLoach defendants.

Petitioner argues that his property interest attached before December 31, 1968, as a result of an oral promise

by Etta DeLoach Sykes to convey the lands. Petitioner concedes that there was no formal written contract between himself and any of the DeLoach family members with respect to the conveyance of acreage in the John Burgess Survey. He points to Etta DeLoach Sykes' signature on the reverse side of the service citation of the suit in the District Court to quiet title No. 7754 as representing a sufficient indication of her intent to convey to petitioner the property in issue.

The mere signature of Etta DeLoach Sykes on this document is clearly not sufficient to transfer any property interest to petitioner. Certainly Etta DeLoach Sykes may have signed the service citation for other reasons, such as a designation to the sheriff of receipt of the complaint. The signature alone or even when combined with the contents of the complaint, lacks the attributes of a written contract to transfer a property interest to petitioner. Thus, we conclude that no written contract existed which gave petitioner any interest in the 100 acres of land located in the John Burgess Survey, Polk County, Texas.

Even if petitioner had an oral contract with Etta DeLoach Sykes and other DeLoach family members entitling petitioner to an interest in the Polk County tracts, the contract would not be a valid conveyance of real estate. The Texas Statute of Frauds requires a written agreement signed by the person to be charged with that agreement for a valid conveyance of real property. Tex. Bus. & Com. Ann. sec. 26.01 (Vernon 1968). Citing case law based upon Vernon's Annotated Civil Statutes, Article 3995(4), a predecessor of section 26.01, petitioner argues that the Statute of Frauds is "not applicable to a contract for the joint acquisition of an interest in realty by a plaintiff [pe-

titioner herein] and another where part of the money and services in the venture are furnished by the plaintiff."[3]

Texas law requires the presence of the following essential elements for the formation of a joint venture: (1) mutual right of control, (2) community of interest, (3) agreement to share profits as principals, and (4) agreement to share expenses, costs and losses. E.g., *Chandler v. Herndon,* 450 S.W.2d 703 (Tex. Civ. App. 1970); *Brown v. Cole,* 155 Tex. 624, 291 S.W.2d 704 (1956). The record does not reflect facts sufficient to support petitioner's claim that his relationship with Etta DeLoach Sykes had the attributes of a joint venture formed to acquire an interest in realty.

Petitioner further asserts that by virtue of his being the attorney for Etta DeLoach Sykes, such a confidential relationship precludes the necessity of complying with the Statute of Frauds. We do not agree with petitioner. The mere existence of a confidential relationship does not excuse noncompliance with the Statute of Frauds. *Dairy Queen of Duncanville, Inc. v. O'Quinn,* 502 S.W.2d 889 (Tex. Civ. App. 1973).

We are of the opinion that petitioner did not receive a vested property interest in any Polk County land by virtue of his rendering legal services to any DeLoach family member. Accordingly, petitioner is not entitled to deduct $12,500 on his 1971 income tax return for a loss resulting from the condemnation of land by the Trinity River Authority of Texas.

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[3] Petitioner cites in support of this contention *De Proy v. Progakis,* 259 S.W. 620 (Tex. Civ. App. 1923); *Wood v. Gulf Production Co.,* 100 S.W. 2d 412 (Tex. Civ. App. 1936).

At trial petitioner alternatively argues that he is entitled to deduct in 1971 a loss resulting from a prospective interest in the proceeds paid by the Trinity River Authority of Texas with regard to the condemnation of tracts E-53, E-54, and E-56 in Polk County. Petitioner claims that he included that prospective interest, approximately $300, in his income for calendar years 1967 or 1968. Therefore, petitioner insists that he is entitled to a $300 deduction. Petitioner confirms that he did not file a Federal income tax return for either 1967 or 1968, but without further explanation or production of evidence he refers us to section 6012(a)(1)(A)(i).[4]

A cash basis taxpayer is not entitled to deduct losses of anticipated income not received or reported. *Hutcheson v. Commissioner,* 17 T.C. 14, 19 (1951); *Hendricks v. Commissioner,* 406 F.2d 269, 272 (5th Cir. 1969). In an effort to render this rule inapplicable in the instant case, on brief petitioner refers to his accounting method used for reporting income as a "quasi-accrual" method. He claims that, although unreported, he accounted for the $300 in-

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[4] Section 6012(a)(1)(A)(i) provides:

SEC. 6012. Persons Required To Make Returns of Income.

(a) General Rule.—Returns with respect to income taxes under subtitle A shall be made by the following:

(1)(A) Every individual having for the taxable year a gross income of $1,000 or more, except that a return shall not be required of an individual (other than an individual described in subparagraph (C))—

(i) who is not married (determined by applying section 143), is not a surviving spouse (as defined in section 2(a)), and for the taxable year has a gross income of less than $3,300,

terest by a quasi-accrual method in 1967 or 1968 and is therefore entitled to a $300 loss deduction in 1971.

Section 446(c) (1) and (2) permits a taxpayer to report income by either the cash basis method or an accrual method. Section 446(c) (4) and section 1.446-1(c) (1) (iv), Income Tax Regs., allow the usage of a hybrid method in connection with a trade or business as long as income is clearly reflected and the method is consistently used.[5] *Caldwell v. Commission,* 202 F.2d 112 (2d Cir. 1953), affg. and modifying in part a Memorandum Opinion of this Court. The record is void of any evidence to indicate that petitioner consistently has used either an accrual method or a quasi-accrual/hybrid method of reporting his income with respect to his law practice.

In his 1971 income tax return petitioner listed himself as a cash basis taxpayer. We recognize that the label noted on a taxpayer's tax return is not binding. *Aluminum Castings Co. v. Routzahn,* 282 U.S. 92, 99 (1930); *Lincoln Storage Warehouses v. Commissioner,* 13 T.C. 33, 41 (1949), affd. without discussion on this point 189 F.2d 337 (3rd Cir. 1950). Where the facts so warrant, minor deviations from a strict cash basis accounting method are permissible. *Rowe v. Commissioner,* 7 B.T.A. 903 (1927).

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[5] Section 446(c) provides:

(c) Permissible Methods.—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary.

But particular income items cannot be reported on an accrual basis unless the taxpayer has a fixed right to receive the income and the amount can be at least approximated. *Spring City Foundry Co. v. Commissioner,* 292 U.S. 182 (1934); *Helvering v. Enright's Estate,* 312 U.S. 636 (1941).

This record does not show that petitioner had a fixed right to receive $300 as a prospective interest in the proceeds paid by Trinity River Authority with regard to the condemnation of the Polk County land. Petitioner failed to present sufficient evidence to support his opinion that he had such a definite right.

Petitioner has not shown that in 1971 he was not a cash basis taxpayer, nor alternatively, that he was on the cash basis and was justified in making minor deviations therefrom by reporting a certain item on an accrual method of accounting. We conclude that petitioner was a cash basis taxpayer in 1971.

At best any claim he might have to the $300 loss arises because of promised but unpaid salary. A failure to realize anticipated income is not equivalent to a loss. *Marks v. Commissioner,* 390 F.2d 598 (9th Cir. 1968), affg. a Memorandum Opinion of this Court. Therefore petitioner is not entitled to a $300 loss deduction resulting from a later inability to collect income prospective in nature and previously unreported.

The second issue concerns whether petitioner is entitled to a calendar year 1971 loss of $14,583.33 from the operation of Lake Livingston Washateria, Inc. Washateria became a chartered corporation in Texas on May 6, 1971. Petitioner contends that a proper section 1372 subchapter

S election was made by the company on May 6, 1971.[6] Respondent disagrees and submits that the election was made

[6] Section 1372(a) and (c) provide:

SEC. 1372. Election by Small Business Corporation.

(a) Eligibility.—Except as provided in subsection (f), any small business corporation may elect, in accordance with the provisions of this section, not to be subject to the taxes imposed by this chapter. Such election shall be valid only if all persons who are shareholders in such corporation—

(1) on the first day of the first taxable year for which such election is effective, if such election is made on or before such first day, or

(2) on the day on which the election is made, if the election is made after such first day, consent to such election.

* * *

(c) Where and How Made.——

(1) In general.—An election under subsection (a) may be made by a small business corporation for any taxable year at any time during the first month of such taxable year, or at any time during the month preceding such first month. Such election shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.

(2) Taxable years beginning before date of enactment. —An election may be made under subsection (a) by a small business corporation for its first taxable year which begins after December 31, 1957, and on or before the date of the enactment of this subchapter, and ends after such date at any time—

(A) within the 90-day period beginning on the day after the date of the enactment of this subchapter, or

(B) if its taxable year ends within such 90-day period, before the close of such taxable year.

An election may be made pursuant to this paragraph only if the small business corporation has been a small business corporation (as defined in section 1371(a)) on each day after the date of the enactment of this subchapter and before the day of such election.

on March 6, 1971, two months before the actual incorporation of Washateria. Petitioner has the burden of proving that respondent is incorrect.

The record includes conflicting evidence as to the correct date of the purported small business corporation election by the Washateria shareholders. The 1971 income tax return completed for Washateria shows the small business corporation election date as March 6, 1971, two months before incorporation. Washateria's 1972 and 1973 income tax returns indicate the election date as May 6, 1971, the date of incorporation. Petitioner testified that the election date appearing on the 1971 tax return was a typographical error and that May 6, 1971, as shown on the 1972 and 1973 tax returns, is correct.

Petitioner advances the position that even if the small business corporation election was made on March 6, 1971, its effective date was deferred and rendered binding under Texas law on May 6, 1971, the date of Washateria's legal incorporation. A basic tenet of Federal tax law was stated in *Burnet v. Harmel,* 287 U.S. 103, 110 (1932):

> Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. The exertion of that power is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation. * * * State law may control only when the federal taxing act, by express language or necessary implication,

> makes it own operation dependent upon state law.
> * * *

Neither has Congress expressly nor impliedly suggested that the election of small business corporation status depends on state law. Petitioner's argument is without merit.

If March 6, 1971, was the date on which shareholders consented to treat Washateria as a small business corporation, this case would be similar to that of *Frentz v. Commissioner*, 44 T.C. 485 (1965), affd. without discussion, 375 F.2d 662 (6th Cir. 1967). There the taxpayers acquired the stock of Ohio Valley Broadcasting, Inc., a small business corporation within the meaning of section 1371 (b).[7] Upon the acquisition of the Ohio Valley stock, the taxpayers consented to the existing subchapter Selection in order to keep that election in effect. The taxpayers intended to dissolve Ohio Valley and to form a new corporation, Kentuckiana Broadcasting, Inc., to operate their radio station. Moreover, the taxpayers planned for Kentuckiana to qualify as an electing small business corporation.

The design called for Kentuckiana to commence operation on November 1, 1959, with the first fiscal year beginning thereon. Within the first month of the first anticipated fiscal year, a subchapter S election was made and all shareholder consents were filed. Hower, the Articles of

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[7] Section 1371(b) reads as follows:

(b) Electing Small Business Corporation.—For purposes of this subchapter, the term "electing small business corporation" means, with respect to any taxable year, a small business corporation which has made an election under section 1372-(a) which, under section 1372, is in effect for such taxable year.

Incorporation were not filed and the charter was not issued until January 11, 1960, about six weeks after the filing of the small business corporation election. We held that the strict language of section 1372 requires the business to assume formal corporate status before or on the date of filing the small business corporation election. Because Kentuckiana did not operate as a corporation or begin its first tax year until January 1960, the purported subchapter S election by the taxpayers was invalid and void.

In the instant case the validity of the purported small business corporation election is further unsupportable. Section 1372(a) requires that all shareholders of the electing corporation consent in writing to the subchapter S election. Neither the shareholder consent Form 2553 nor a copy thereof was entered into evidence. Nor is there other evidence sufficiently convincing that all shareholders consented to the election within the period prescribed by section 1371(a). Therefore we conclude that Washateria was not a valid small business corporation within the meaning of section 1371(b) in 1971.

Even if Washateria were a subchapter S corporation within the meaning of section 1371(b), the loss would not be deductible by petitioner. Petitioner claims that he became a shareholder of Washateria in 1971 and that his contribution to capital consisted of cash, a 1971 Vega with a cost basis of $2,929.95, and three-quarters of his 50 percent interest in the 100 acres of land located in the John Burgess Survey, Polk County, Texas. The 1971 income tax return completed for Washateria does not explain the components comprising the corporate net loss of $37,500, of which petitioner claimed $14,583.33 as his share.

Yet petitioner's brief coupled with his testimony indicates that the entire $37,500 corporate loss was attributable to the condemnation of the Polk County property.

The facts control whether a taxpayer has made a valid property transfer effective for Federal income tax purposes. *Wilson v. Commissioner,* 560 F.2d 687, 690-691 (5th Cir. 1977), affg. a Memorandum Opinion of this Court. Because we have already concluded that petitioner had no vested interest in any of the lands in Polk County, any alleged transfer of such property to the corporation, although evidenced by a document entitled "Quit-claim deed", would be invalid and without effect for Federal income tax purposes. Consequently, the $14,583.33 loss is not deductible by petitioner.

Petitioner argues that respondent failed to timely contest the claimed loss attributable to the operation of Washateria. This argument is without merit. Section 6501 (a) and (b) provide for three years from the date of the filing of the income tax return for assessment of the tax. For this purpose, if the return is actually filed prior to the final date provided by law, the filing date is considered to be the last day allowable for filing of such return.[8] In the instant case

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[8] SEC. 6501. Limitations on Assessment And Collection.

(a) General Rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

(b) Time Return Deemed Filed.—

petitioner's income tax return for calendar year 1971 was signed on March 1, 1972, and it subsequently was filed. Respondent mailed the notice of deficiency on January 22, 1975, well within the allowable three-year period.

On brief petitioner alternatively argues that if Washateria were instead a joint venture, the loss would be allowed to each venturer. However, we refrain from considering that proposed situation since the argument was not timely raised in the pleadings. See *McMaster v. Commissioner,* 69 T.C. 952, 956 (1978); *Frentz, supra* at 490-491; *Molbreak v. Commissioner,* 61 T.C. 382, 393 (1973), affd. 509 F.2d 616 (7th Cir. 1975).

The final issue for decision is whether any part of the deficiency in petitioner's income tax for calendar year 1971 was due to negligence or intentional disregard of the rules and regulations under section 6653(a). Respondent's determination in the notice of deficiency that a portion of an underpayment of taxes is due to negligence or intentional disregard of rules and regulations is presumptively correct, and the taxpayer has the burden of proving that the levying of the addition to tax is erroneous. *Courtney v. Commissioner,* 28 T.C. 658, 669 (1957); *Marcello v. Commissioner,* 380 F.2d 499, 506 (5th Cir. 1967), affg. in part and remanding in part a Memorandum Opinion of this Court.

We conclude on the basis of this record that petitioner has failed to carry this burden. The record does not show

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(1) Early return.—For purposes of this section, a return of tax imposed by this title, except tax imposed by chapter 3, 21, or 24, filed before the last day prescribed by law or by regulations promulgated pursuant to law for the filing thereof, shall be considered as filed on such last day.

that adequate records of the interest petitioner held in Washateria or the income or deductions of that entity for 1971 were maintained by petitioner even though petitioner claimed a loss from the operation. In fact petitioner did not enter into evidence the records, if any, that he maintained with respect to the condemnation loss. In our view petitioner has failed to show error in respondent's determination of an addition to tax under section 6653 (a).

Decision will be entered for respondent.

UNITED STATES TAX COURT

Washington, D.C. 20217

Docket No. 2791-75.

ELIJAH W. RATCLIFF

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion filed January 17, 1980, it is

ORDERED and DECIDED: That there is a deficiency in income tax due from the petitioner for the taxable year 1971 in the amount of $6,435.36, and an addition to tax under section 6653 (a) , I.R.C. 1954, in the amount of $321.77.

Irene F. Scott

Irene F. Scott

Judge

Entered: Jan. 18, 1980

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 16th day of October, one thousand nine hundred and eighty.

80-4090

Present:

Honorable Wilfred Feinberg, Chief Judge

Honorable Ellsworth A. Van Graafeiland, Circuit Judge

Honorable James S. Holden, District Judge*

United States Court of Appeals

Filed Oct. 16, 1980

A. Daniel Fusaro, Clerk, Second Circuit

80-4090

ELIJAH W. RATCLIFF,

Appellant

—against—

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

Appeal from The Tax Court of the United States.

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* United States District Judge for the District of Vermont, sitting by designation.

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by appellant, pro se and by counsel for appellee.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed for the reasons given in the opinion of The Tax Court, Irene F. Scott, J., filed January 17, 1980.

In addition, appellant's motion for an order "Allowing Only Specific Marshaling of Assets" is denied.

Wilfred Feinberg
WILFRED FEINBERG,
Chief Judge

Ellsworth A. Van Graafeiland
ELLSWORTH A. VAN GRAAFEILAND
Circuit Judge

James S. Holden
JAMES S. HOLDEN,
District Judge

N.B. Since this statement does not constitute a formal opinion of this court and is not uniformly available to all parties, it shall not be reported, cited or otherwise used in unrelated cases before this or any other court.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 18th day of December, one thousand nine hundred and eighty.

No. 80-4090

United States Court of Appeals

Filed Dec 16 1980

A. Daniel Fusaro, Clerk, Second Circuit

ELIJAH W. RATCLIFF,

Appellant

—against—

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Elijah W. Ratcliff, pro-se.

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge on the panel that heard the appeal and that no such judge has requested that a vote be taken thereon.

A. Daniel Fusaro
A. Daniel Fusaro
Clerk

APPENDIX, PART B

UNITED STATES CODE, CONST. AMEND. V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb, nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.

UNITED STATES CODE, CONST. AMEND. XIV

SECTION I

1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law, nor deny to any person within its jurisdiction the equal protection of the law.

TITLE 26, UNITED STATES CODE, SECTION 165 (a)

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

CCH Reg. §1.446-1 (e) (1)

(e) Requirements respecting the adoption or change of accounting method. (1) A taxpayer filing his first return may adopt any permissible method of accounting in computing taxable income for the taxable year covered by such return. See section 446 (c) and paragraph (c) of this section for permissible methods. Moreover, a taxpayer may adopt any permissible method of accounting in connection with each separate and distinct trade or business, the income from which is reported for the first time. See section 446 (d) and paragraph (d) of this section. See also section 446 (a) and paragraph (a) of this section.

VERNON'S ANN. RULES CIV. PROC., RULE 94

Rule 94. Affirmative Defenses

In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, and any other matter constituting an avoidance or affirmative defense. Where the

suit is on an insurance contract which insures against certain general hazards, but contains other provisions limiting such general liability, the party suing on such contract shall never be required to allege that the loss was not due to a risk or cause coming within any of the exceptions specified in the contract, nor shall the insurer be allowed to raise such issue unless it shall specifically allege that the loss was due to a risk or cause coming within a particular exception to the general liability; provided that nothing herein shall be construed to change the burden of proof on such issue as it now exists. Amended by order of March 31, 1941, effective Sept. 1, 1941.